

## MINUTES

BOARD OF TRUSTEES OF THE  
PUBLIC EMPLOYEES' RETIREMENT FUND  
143 West Market Street, Suite 500  
Indianapolis, IN 46204

February 9, 2001

### Trustees Present

Richard Doermer, Chair  
Nancy Turner, Vice Chair  
Jonathan Birge  
Teresa Ghilarducci  
Steven Miller

### Others Present

Mike Gery, Executive Assistant to the Governor  
Mary Beth Braitman, Ice Miller  
Diana Hamilton, Special Liaison to the Governor for Public Finance  
Pete Keliuotis, Wm. M. Mercer Investment Consulting  
Richard Boggs, Burnley Associates  
Dan Rives, Indiana University  
Karen Franklin, National City Bank  
Faith Berning, National City Bank  
E. William Butler, PERF Executive Director  
Eric Swank, Ice Miller (Acting as PERF Counsel)  
Diann Clift, PERF MIS Director  
Patrick Lane, PERF Director of Communications  
Linda Stahl, Recording Secretary

### ITEMS MAILED TO THE BOARD PRIOR TO MEETING

- A. Agenda of February 9, 2001 Meeting
- B. Minutes:
  - ☐ January 12, 2001 Board Meeting
- C. Proposed Legislation
  - ☐ Senate Bill 562
  - ☐ House Bill 1603

A quorum being present, the meeting was called to order.

1. MINUTES APPROVAL

**MOTION** duly made and carried to approve the Minutes of the January 12, 2001 meeting of the Board of Trustees.

*Proposed by: Teresa Ghilarducci*

*Seconded by: Steven Miller*

*Votes: 5 for, 0 against, 0 abstentions*

2. BOARD DISCLOSURES

Richard Doermer – Bank One stock ownership

3. ADMINISTRATIVE

Valic Request

Mark Scherer, representing the Variable Annuity Life Insurance Company (VALIC), recently contacted PERF asking for an opportunity to discuss some additional investment options with the Board of Trustees. Specifically, Mr. Scherer wanted to address the establishment of an additional alternative investment program within the annuity savings accounts of members, which would consist of retirement annuities provided by insurers licensed in Indiana.

The Trustees undertook discussion of this matter wherein it was noted that the letter of request does speak to the fact that PERF members need education. Clearly, the Board recognizes that fact and is moving forward. However, the VALIC letter implies that the Board is not serving their members by not hiring insurance companies and allowing competition. There is also no recognition that VALIC would educate the PERF members on the most valuable part of their pension --- the defined benefit plan. So, the letter of request seemed very unresponsive on who PERF is, what Indiana is about, and on the structure of PERF benefits.

Based upon further discussion of the request, the Trustees felt it would serve no purpose to meet with VALIC concerning this matter. Additionally, it was noted that while the Board is not to the point of even considering an option of this nature, it would be a departure from their normal procedural process to meet individually with any firm offering such services. The hiring of such a firm would be handled through the standard Request for Proposal process. The Executive Director was asked to convey the Board's decision to VALIC.

### SIRIS/Backfile Update

Diann Clift noted that the SIRIS project is still on schedule to go live on March 5. Staff has been committed to testing the system from 8:00 a.m. until 12:00 p.m. daily. When there is a problem, a Problem Incident Report (PIR) is generated. Currently, there are 159 PIR's outstanding. Those will not all be rectified before the system goes live. However, there are 33 such items (7 belonging to PERF) that need resolution prior to rollout. Negotiations are currently underway to see if there is a viable way of working around those problems on a temporary basis. If one can be found that would minimize impact to staff and business operations, resolution of those PIR's will also be postponed until after the system has been brought on-line.

With respect to backfile conversion, 28 boxes of files were shipped for electronic imaging. However, the error rate on those returned files was very high. Therefore, the project was put on hold pending resolution of the matter.

### Employer Communications

Dan Rives, Director of Benefits for Indiana University (IU), was present to discuss the matter of employer communications. Mr. Rives has a number of concerns with respect to IU's relationship with PERF.

By way of background, Mr. Rives noted that IU has approximately 17,000 employees covered by retirement plans. Some 7,000 of those are covered by PERF, and IU has a sense of responsibility and accountability to those plan participants. However, IU does not feel a partnership with PERF in fulfilling that responsibility. They do not feel there is the opportunity for a lot of communication on a variety of matters, including legislative changes or other administrative components. IU frequently hears about some of those matters from plan participants or other retirement plan vendors, not from PERF. Frequent communications with PERF's Executive Director conveys the desire for such communications. However, there doesn't seem the means to make that happen. Thus, Mr. Rives felt a vested interest to elevate that discussion. Between union groups and other councils who look at the other retirement plans where there is a stream of information, question is raised as to why PERF is not doing a similar job for their participants. To help facilitate a better communication flow, Mr. Rives offered recommendations as follows:

- Conducting quarterly or semi-annual business meetings to keep PERF employers informed on such matters as the performance of the investments within the trust fund, potential investment options to be made available for plan participants, where the Fund is going administratively, etc.
- Generating reports of employer accounting.
- Involving employers in communication pieces distributed to plan participants.

Mr. Butler noted that he and Mr. Rives had previously discussed the creation of an employer advisory group. Mr. Rives was not only very supportive of the idea and very willing to become involved but also to make the resources of the University available as needed.

Chair Doermer commented that Mr. Rives' comments were very constructive, and the Board wants to respond. They are now responding in a number of areas, addressing investment challenges in particular and trying to develop the muscle to add the staff necessary to do the kind of things the Board knows must be done. Thus, Mr. Rives' presentation affects the Board's sense of priorities in a significant way. Hopefully, funding efforts can be accelerated to create the staff that would enable the Fund to serve more efficiently in matters of this nature.

### Unit Enlargement

The West Lafayette School Corporation, under its original Resolution for PERF coverage, did not include the position of Business Manager. Traditionally, that position would have been covered under the Teachers' Retirement Fund. However, the school now has a Business Manager who is not a teacher and, therefore, needs to enlarge their PERF Resolution to cover that position. West Lafayette originally contacted PERF in March 2000 concerning this enlargement. However, due to a breakdown in communications, nothing was ever brought before the Board.

**MOTION** duly made and carried to accept the West Lafayette School Corporation's enlargement resolution, completed on March 29, 2000, to cover the position of Business Manager.

*Proposed by: Jonathan Birge*

*Seconded by: Nancy Turner*

*Votes: 5 for, 0 against, 0 abstentions*

### Rules Hearing

A bill was passed in 1999 formalizing cost-of-living allowance procedures. In accordance with the law, PERF has been using those procedures. However, there were some glitches in the rule-making process in 1999 and 2000 such that the process had to be started again last fall. Thus, a public hearing was conducted on January 29, 2001 to discuss the proposed rules as follows:

#### SECTION 1. 35 IAC 1.2-8 IS ADDED TO READ AS FOLLOWS:

##### Rule 8. Cost-of-Living Adjustment

##### 35 IAC 1.2-8-1 Calculation

Authority: IC 5-10.3-3-8

Affected: IC 5-10.2-5-29; IC 5-10.2-5-30

Sec. 1. A cost-of-living adjustment based on purchasing power replacement shall be calculated using the following elements for determinations made as of July 1:

- (1) The Consumer Price Index-W from the prior March 31 shall be used.
- (2) For comparative purposes, the appropriate prior years' March 31 Consumer Price Index-W numbers shall be used.
- (3) Retirees will be grouped (based on their latest retirement or disability date) by twelve (12) month periods running from July 2 through the following July 1. A single net adjustment percentage shall be calculated for each such group.
- (4) Minimum and maximum amounts in prior postretirement adjustments shall not be taken into account.
- (5) So-called "13<sup>th</sup> checks" shall not be taken into account.

*(Board of Trustees of the Public Employees' Retirement Fund; 35 IAC 1.2-8-1)*

#### 35 IAC 1.2-8-2 Formula

Authority: IC 5-10.3-3-8

Affected: IC 5-10.2-5-29; IC 5-10.2-5-30

Sec. 2. (a) The elements established in section 1 of this rule shall be used in the formula in subsection (b).

(b) Compare the cumulative Consumer Price Index increase for an affected group to the cumulative postretirement cost-of-living adjustments for that group, as determined under section 1 of this rule, and increase that group's pension portion by the percentage (if any) determined by the fund actuary, as necessary to reach the minimum purchasing power established by the Indiana general assembly, for example:

- (1) fifty percent (50%) for 1999; and
- (2) fifty-seven and four-tenths percent (57.4%) for 2000.

*(Board of Trustees of the Public Employees' Retirement Fund; 35 IAC 1.2-8-2)*

#### 35 IAC 1.2-8-3 Increases

Authority: IC 5-10.3-3-8

Affected: IC 5-10.2-5-29; IC 5-10.2-5-30

Sec. 3. The increase shall be applied as of July of any year established by the general assembly, the first such year beginning July 1, 1999.

*(Board of Trustees of the Public Employees' Retirement Fund; 35 IAC 1.2-8-3)*

Following Board discussion,

**MOTION** duly made and carried to adopt the cost-of-living allowance procedures as noted.

*Proposed by: Teresa Ghilarducci*

*Seconded by: Steven Miller*

*Votes: 5 for, 0 against, 0 abstentions*

#### 4. LEGISLATION

Mary Beth Braitman provided a synopsis of pending legislation as follows:

➤ Senate Bill 95 – Local Unit Participation in PERF

Authorizes a political subdivision that is not a participant in PERF to provide, outside PERF, a system of retirement, disability, and survivor benefits for public employees of the political subdivision.

➤ Senate Bill 260 – Pension Relief Fund Distributions

This bill provides three things. One, it provides that pension relief distributions would be made on a current-year basis. Thus, distributions would be made based upon what PERF's actuary calculates each unit's spending to be in a given year rather than what they spent in the previous year. Secondly, it provides that at least 50% of each unit's pension liability is paid from the pension relief fund. Third, it provides for the creation of a separate unit account into which each unit may make deposits and on a once-a-year basis withdraw all or a portion of that account to pay pension benefits.

➤ Senate Bill 562 – Venture Capital Investments

Establishes the Indiana Investment Company, and requires both PERF/TRF to use this firm as the Funds' exclusive agent for the management and investment of assets allocated to private capital investments.

➤ House Bill 1190 – Cafeteria Plan for Retired State Employees

Increases from \$5,000 to \$10,000 the maximum amount that may be deposited into a cafeteria plan on behalf of a participating retired state employee who has unused vacation, sick, or personal days.

➤ House Bill 1194 – Earnings Limitation for PERF/TRF Retirees

Reimposes an annual earnings limit on a retired member of PERF/TRF who has not attained the Social Security normal retirement age for unreduced benefits. Provides that: 1) if such a retired member is reemployed in a position covered by PERF/TRF and earns more than \$25,000 in a year, the member's retirement benefit is suspended, and 2) a retired member who has attained normal retirement age for unreduced benefits may be reemployed in a covered position without a suspension of retirement benefits.

➤ House Bill 1237 – Pension Investment Options

Provides that a member of PERF/TRF may change the allocation among available funds of the amount credited to the member's annuity savings account once each quarter.

➤ House Bill 1265 – PERF Pension Benefits

Makes a number of changes for the provision of a higher PERF retirement benefit to include: 1) decreasing from 20 to 12 the number of calendar quarters used in determining a pension benefit, 2) increasing from 1.1% to 1.2% the multiplier used in calculating a benefit for those individuals who retire after June 30, 2001 and from 1.1% to 1.3% for those individuals who retire after June 30, 2001, and 3) increasing from 3% to 5% of the member's compensation the amount of the contribution paid by the employer.

➤ House Bill 1286 – PERF/TRF Administrative Issues

This is the PMOC omnibus bill, which includes miscellaneous corrections/clarifications. Discussion has been undertaken to add language to the bill that would provide authority to conduct meetings electronically and also to clarify that PERF is maintaining confidential personnel records, including members' Social Security numbers, names, account balances, investment options, etc. As such, that information is not available for release.

➤ House Bill 1603 – McCray Hospital Pension Account

Directs PERF to transfer the fund account of a county-funded hospital that is sold to a private entity to the fund account of the county that funded the hospital and to add the transferred amount to the county's fund account. Also provides that the county assumes all of the assets and liabilities attributable to the hospital's account, except for any liability for employer contributions that arose before January 1, 2000.

➤ House Bill 1606 – Retirement Fund Annuity Investments

Provides that the PERF/TRF Boards shall maintain an alternative investment program consisting of at least four retirement annuities.

➤ House Bill 1815 – PERF/TRF Colas

Provides varying cost-of-living adjustments for the years 2001 and 2002.

## 5. INVESTMENTS

### Domestic Equity RFP Update

Pete Keliuotis reported that the domestic equity search was split into pieces --- one for enhanced index managers, which have a lower tracking error, and one for active managers, which have a higher tracking error. A total of 115 firms responded. Mercer ranked those firms according to different risk measures and came up with a list of recommended semi-finalists for each of the categories. Following discussion of that list, the Board recommended a further screening to include managers for whom Mercer would do a more comprehensive evaluation. The Investment Committee will then review that smaller list of firms and select those they wish to interview.

### MSCI Free Float Issue

The firm of Morgan Stanley Capital International (MSCI) publishes a performance measure to be used for PERF's international managers. MSCI has decided to make some changes in the way their indices are constructed and to have a broader representation of the markets. Additionally, they want to adjust for what's called "free float" in a sense that in a lot of foreign markets much of the share ownership is held by other institutions. Thus, it's important to recognize in those instances that the average investor, whether it's an individual investor or an institutional investor located outside that country, doesn't have access to those shares. Rather, they only have access to the free float shares, which are shares actually traded actively in the market. So MSCI is adjusting not only to reflect a broader capitalization coverage within each of their markets, but also to adjust to this free float. As a result of that, they are changing the index construction in two phases. One is going to be in November of 2001 and the other in May of 2002. Since PERF is just now getting into international investments, there is an issue on the part of managers as to whether they benchmark themselves off the anticipated structure of the new indices or use the current structure and change the portfolio to reflect the new indices once they are implemented. If the current indices are used, PERF would incur some transaction costs in moving over to the new structure. If the anticipated index structure is used, there is an issue of tracking error relative to the current benchmark since the new proposed indices aren't published as yet. It would be Mercer's recommendation that the proposed indices be used. There would still be a broad exposure to the asset class with international equity investment, but the money on the transaction side could be saved by not incurring a lot of portfolio turnover, recognizing that there would be some tracking error relative to the index in the interim period.

### International ASA Choice

The matter of adding international equity as an annuity savings account (ASA) option was brought before the Board. Mr. Keliuotis noted that National City Bank



needs to have a portfolio priced by SEI when an equity is offered in the ASA program. If that is not set up with SEI at the initial funding stage, it is very difficult for National City to make that change and have the portfolio priced when the option is made available.

The floor was opened for Board consideration of this matter. Observations made included: 1) an international equity option does not add anything to the participants, and in the context of where the Board is and what they are doing, the addition of such an option is premature, and 2) if the Board felt 10% of the defined benefit assets should be placed in internationals, why shouldn't the participants have that opportunity? Following further discussion,

**MOTION** duly made and carried to offer an international equity option in the Annuity Savings Account program.

*Proposed by: Steven Miller*  
*Seconded by: Jonathan Birge*  
*Votes: 4 for, 1 against (Ghilarducci), 0 abstentions*

**MOTION** duly made and carried to use the State Street Managed Index Fund as the international option.

*Proposed by: Steven Miller*  
*Seconded by: Nancy Turner*  
*Votes: 4 for, 0 against, 1 abstention (Ghilarducci)*

### Securities Lending

Mr. Keliuotis noted that there had been some confusion as to whether the Board wanted international equity assets to be included in the securities lending program. If they are included, the Investment Policy needs to be revised to reflect that.

Steve Miller responded that he had recently attended a securities lending conference where a number of questions were raised. The whole process is a very complicated one involving both borrower default and collateral reinvestment risk. It was Mr. Miller's recommendation that the matter of global securities lending be delayed until such time as the Board was better versed on the matter.

### Hughes Capital Management

Two issues have been brought to light with respect Hughes Capital Management. One, the only portfolio manager on staff besides Frankie Hughes left the firm. The individual hired to fill that position appears to be very competent. Secondly, Ms. Hughes' agreement with Loomis Sayles to provide research resources has expired. That leaves a question as to whether the Board feels comfortable with Hughes without the Loomis Sayles research supporting them. Mercer will be monitoring this situation closely.

### Investment Consultant

As the Board moves forward in fulfilling the targeted asset allocations as established in their Investment Policy,

**MOTION** duly made and carried to grant authority to the Executive Director to begin efforts to locate a consultant specializing in private equity investments who would become a consultant to the Fund, perhaps in partnership with the Teachers' Retirement Fund.

*Proposed by: Steven Miller*  
*Seconded by: Jonathan Birge*  
*Votes: 5 for, 0 against, 0 abstentions*

### 5. NEXT MEETING

The next meeting of the Board will be conducted on March 9, 2001.

### 6. ADJOURNMENT

There being no further business, the meeting was adjourned. An Executive Session of the Board followed to discuss personnel issues.